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No. 12,465.

United States Court of Appeals

FOR THE SIXTH CIRCUIT.

HENRY P. WHITE, and ESTATE OF NANCY A. WHITE, deceased,
T. LEO SULLIVAN, ADMINISTRATOR, C. T. A.,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF AND APPENDIX OF PETITIONERS.

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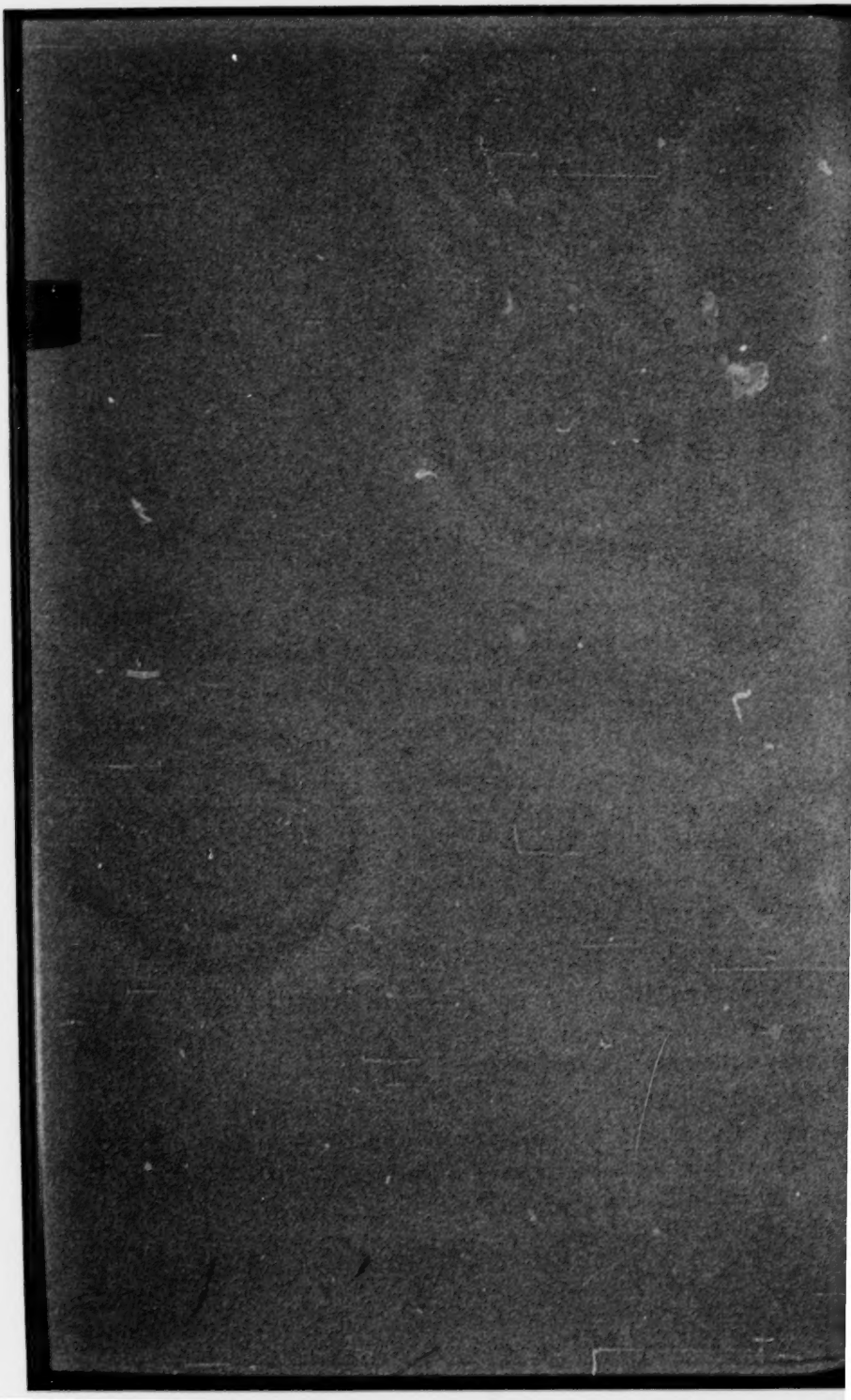

STATEMENT OF THE QUESTIONS INVOLVED.

1. Was the taxpayer, Henry P. White, in his operation of a wholly owned laboratory specializing in guns and ammunition research and related matters, in the years 1948 and 1949 engaged in conduct of a business of such character that his ordinary and necessary expenses of such business were properly deductible from the taxpayers' gross income under provision of Internal Revenue Code of 1939, section 23 (a) (1) (A) in computing the taxable income of himself and wife upon their joint returns for those years?

The Court answered this question "No."

The taxpayers contend that the answer should be "Yes."

2. Two issues presented by the pleadings were determined by the Tax Court.

One involved the question whether there were deficiencies of the joint income tax liability of the taxpayers, who were husband and wife, for the calendar year 1948 of $1,088.51, and for the year 1949 of $10,014.28, or in the total amount of $11,102.79.

The Court answered this question "Yes."

The taxpayers contend that the answer should be "No."

3. The other issue involved the question of the taxpayers' right to a refund of $7,671.75 which had been duly claimed by them as overpayment of income tax for the year 1948.

This claimed overpayment was the sum of two items: One was the consequence of an arithmetical error to the disadvantage of the taxpayers upon the face of the taxpayers' return for that year, and the other the amount of understatement of estimated tax paid.

That there were such errors was conceded by the Commissioner, and by counsel for the respondent upon the trial.

By its decision that there was a deficiency for the year 1948, the Tax Court answered this question of the right to refund "No."

The taxpayers contend that the answer should be "Yes."

The Court did not enter particular decision upon the question of right to this refund.

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No. 12,445.

United States Court of Appeals

FOR THE SIXTH CIRCUIT.

HENRY P. WHITE, and ESTATE OF NANCY A. WHITE, deceased,

T. LEO SULLIVAN, ADMINISTRATOR, C. T. A.,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF DECISION OF THE TAX COURT OF THE UNITED STATES.

BRIEF OF PETITIONERS.

STATEMENT OF FACTS.

A. NATURE OF THE ACTION.

This case is in this Court on a petition for review from a decision of The Tax Court of the United States, entered of record October 19, 1953.

The petitioners were Henry P. White and Nancy A. White, husband and wife, who filed their action in the Tax Court for the redetermination of income tax deficiencies as claimed by the Commissioner of Internal Revenue, for the years 1948 and 1949.

The Tax Court sustained the findings of the Commissioner on the sole ground that deductions of expenses of a business conducted by the taxpayer Henry P. White, were not ordinary and necessary expenses of a "business"

within contemplation of Sec. 23 (a) (1) (A) of the 1939 Internal Revenue Code. (72a.)

The question of the right to a refund for the year 1948 was also in issue.

In holding that there was a deficiency for the year 1948 the Court determined this question against the claim of the taxpayers, but made no specific entry with regard to it.

B. THE PLEADINGS AND PROCEEDINGS.

The pleadings are the taxpayers' petition and an answer of the Commissioner of Internal Revenue. (2a-11a.)

The questions and issues determined are stated in the prefixed Statement of the Questions Involved.

The case was tried in Cleveland, Ohio, November 11, 1952, before his Honor Clarence V. Opper. His decision that there were deficiencies in income tax of $1,088.51 for 1948 and of $10,014.28 for 1949 was entered of record October 19, 1954. (72a.)

C. THE FACTS.

The Tax Court, under the heading "Findings of Fact" made certain findings and stated certain conclusions. (65a-69a.)

These findings were not numbered, and we have presumed to number them 1 to 14 inclusive in the appendix for the purpose of reference to them separately.

In the argument we shall undertake to direct attention to the inferences and conclusions in some of the numbered paragraphs which we think this Court will find are not supported by any substantial evidence, and which clearly are not warranted upon the entire undisputed evidence and in consideration of the law.

Facts in Evidence to Which the Tax Court's Findings and Opinion Do Not Make Reference.

Very many of the evidential facts essential to determination of the principal question in this case appear in the testimony of the witnesses, which, as printed in the appendix, is detailed here.

Many of the most important of these facts are not referred to in the findings and opinion of the Tax Court.

D. SUBSTANCE OF THE PROOF.

Facts Shown by the Testimony of Henry P. White.

DIRECT:

The taxpayer Henry P. White, testified that his present residence in Bel Air, Maryland, is located about 11 miles from his present installation at Bel Air, and he gave as his reason for locating his new and much larger plant in that region, that it was not too far from Washington and New York and the New England arms manufacturing district, and relatively close to several army and navy proving grounds.

He described the much larger indoor range at Bel Air, and a 400 meter out-door range.

He testified to service of his business to the Government, and to the fact that at the time of the trial he was engaged in performance of a contract with the Navy. (32a-33a.)

He testified that his laboratory had regular hours and that the hours of work were from 8 in the morning until 4:30 in the afternoon, and that he had a time card system. (34a.)

The new laboratory has high speed photographic equipment necessary for the analysis of types of bullet motion as well as certain types of high speed machine

motion. It has a motion picture camera which runs close to 6000 frames per second; and a microflash unit which is a very high speed photo flashlight which enables the capture of a high speed projectile in motion, and its analysis from a photographic plate. (35a-36a.)

A book or catalogue on "cartridge manufacturers and base markings" which was prepared by his organization was sold to various of the agencies of the Government including the Armed Forces, The Federal Bureau of Investigation, and to the law enforcement agencies and peace organizations. (36a-37a.)

This book was marked Exhibit C but was not offered in evidence by either party.

The laboratory had served the National Rifle Association, among others, and the evidence shows that this organization has more than 300,000 dues paying members.

He testified to expectation of important business relations with the National Rifle Association, and that his was the only laboratory in the United States having to do with firearms that is not associated directly with one of the arms or munitions manufacturers. (38a-39a.)

He was doing considerably more business in 1953 than at the same time the year before, and he had confidence that his business would operate in the black in 1954. (39a-40a.)

Mr. White at the time of the trial was spending 90 per cent of his time on laboratory work. (40a.)

Exhibits 1 and 2 were received in evidence. (37a-38a.) Exhibit 1 is a prospectus with photo reproductions of the H. P. White Laboratory at Bel Air, Maryland.

Exhibit 2, dated February 1939, is a letter signed by Guy T. Helvering, Commissioner, designating H. P. White Company as a research laboratory entitled to the exemp-

tion prescribed in section 4 (5) of the Federal Firearms Act.

Exhibit 3 which was a photostat of a private letter, was objected to and not received in evidence.

Mr. White testified directly and positively that at the time when he initiated the Laboratory venture it was his intention to sell his services to the public, and that it was his intention to make a profit; that he consulted with others whom he named, before he went into it.

Among them was the witness Col. Goddard, who was a recognized expert and of long experience in the ballistics field. (40a-41a.)

Mr. White was in the armed services for almost four years during the war, stationed at Aberdeen on 24 hour duty. (41a.)

Exhibits 4 and 5, which were the taxpayers' returns for 1948 and 1949 were received in evidence. (42a.)

CROSS EXAMINATION.

His testimony here shows that White conceived the idea of establishing his laboratory in the winter of 1935; that at about that time he was receiving a moderate income from trusts which had been established for his benefit. In value the trust estate was about two million dollars.

He did not receive any part of the principal of the trust estate in possession until he was 30 years of age. (45a.)

In 1948 The White Laboratory was doing work for the National Rifle Association, and he had installed before that what is described as a universal mount and pressure gun set-up, and White's was the only independent laboratory in the United States which had such equipment.

After the war there was a tremendous amount of material, the cataloguing, measuring, taking cartridges apart, and analysis and weighing the powders of which was, as Mr. White testified—"a tremendous undertaking."

He had acquired thirteen or fourteen thousand rounds of different types of ammunition and his work of this kind had resulted in what he described as being "like a very large and comprehensive library that you go to and get what you want." (46a-47a.)

About in 1948, White published a technical book on Center Fire Metric Pistol and Revolver Cartridges (Exhibit A), and about in 1950, another book entitled Center Fire American and British Pistol and Revolver Cartridges (Exhibit B). (48a-50a.)

Exhibit C was another book to which reference was again made in the cross examination, but it was not offered in evidence. (50a-51a.) Services were rendered to The Ohio Edison Company among others. (51a.)

Exhibit C is referred to as a catalogue of cartridge identification, and some copies were sold to the F. B. I. and the Army, among others. The price was $50.00. (53a.)

Because of its confidential nature this book was not printed in the usual way, but was reproduced from blue prints. (54a.)

White had a cost system for the laboratory in 1948 and 1949 and an improved system after the removal to Maryland. (52a.)

RE-DIRECT EXAMINATION OF H. P. WHITE.

Mr. White and his assistantt, Mr. Munhall, actively solicit business. (55a.)

At the time of the trial the laboratory had on hand from 40,000 to 50,000 rounds of government automatic cannon ammunition, twenty millimeter shells; the laboratory at Bel Air could handle shells of as large caliber as between 20 and 30 millimeters; both guns and ammunition were involved in the government contract being performed at the time of the trial.

Only 45 caliber rifle ammunition could be handled at the White Laboratory in Cleveland. (56a-57a.)

QUESTIONS BY THE COURT.

Q. Do you have an estimate how much capital investment is involved in the plant that is shown in that exhibit? (Ex. 1.) The witness answered: Yes, sir, I should say in the neighborhood of $300,000. (63a.)

In answer to further questions asked by the Court the witness White testified that the highest figure of expense shown by the schedules filed with the 1948 and 1949 returns was for salaries paid in the conduct of the business. (59a-60a.)

He testified with regard to the figures shown for advertising (61a-62a), and to the figures for depreciation. (62a.)

He gave the location of his business before moving to Bel Air. His laboratory was located at E. 90th Street and Euclid Avenue in Cleveland, Ohio.

FURTHER RE-DIRECT EXAMINATION.

The witness testified that he was a sailboat hobbyist. (64a.)

Testimony of Other Witnesses.

Facts shown by the testimony of the witness **Calvin H. Goddard**. Direct:

This witness was a pioneer in the ballistics field whose work was instrumental in developing the science of bullet identification as now in use throughout the world. He, with associates, worked in this field for some years without any return in money. (17a-19a.)

He described the activities of persons who load their own ammunition in effort to obtain more accurate results than are obtainable by use of commercial ammunition and because of saving in cost. These people are known as hand loaders or self loaders.

The White Laboratory can and does render service to such people. (20a-22a.)

Facts shown by testimony of the witness **E. W. Kronbach**. Direct:

Mr. Kronbach is an employee of The Van Dorn Iron Works Company and was engaged in metallurgical work.

About in 1940-41 the Van Dorn Company had received an educational order from the Government for three complete tanks.

They were having a great deal of difficulty in making tests of armor plate, and found that there were few sources of information to aid them in their experiments.

They were put in touch with H. P. White Laboratory which supplied the equipment and information to enable The Van Dorn Company to check the speed of projectiles fired at armor plate in making their tests of such plate.

The Laboratory also assisted in their experimentation. (23a-27a.)

As Mr. Kronbach described it the service was extremely valuable to his company. (25a-26a.)

Facts as shown by testimony of the witness **Arthur E. Hart**. Direct:

Mr. Hart is a gunsmith of long experience and deals in guns and ammunition in Cleveland as the Hart Arms Company. (27a-28a.)

He recommended the White Laboratory to hand loaders.

Facts as shown by testimony of the witness **Harley E. Benthum**. Direct:

Mr. Benthum was Chief of Police of Shaker Heights, Ohio. His department had employed the services of H. P. White Laboratory in 1947 and had again consulted them with regard to type and quantity of powder to be used in hand loading. (28a-30a.)

On re-direct examination the witness testified that the service rendered was very important. (30a.)

Facts shown by testimony of the witness **T. Dickerson Cook**. Direct:

Mr. Cook is director of the Institute of Applied Science in Chicago. It conducts a home study school; identification and investigation work.

Its graduates go into identification bureaus and law enforcement agencies.

His business employed H. P. White Laboratories to rewrite instruction lessons on firearms identification, which are being currently used by its students.

The witness testified that his business had students and graduates in over 50 countries. (30a-31a.)

THE ARGUMENT.

THE FIRST QUESTION INVOLVED.

1. Was the taxpayer, Henry P. White, in his operation of a wholly owned laboratory specializing in guns and ammunition research and related matters, in the years 1948 and 1949 engaged in conduct of a business of such character that his ordinary and necessary expenses of such business were properly deductible from taxpayers' gross income under provision of Internal Revenue Code of 1939, section 23 (a) (1) (A) in computing the taxable income of himself and wife upon their joint returns for those years?

The Tax Court answered this question "No."

The taxpayers contend that the answer should be "Yes."

It is submitted that all of the cases in which the Courts have held that claimed ordinary and necessary business expenses, or losses, of an individual were not deductible on the ground that a purported business was not such within the intent of Internal Revenue Code Section 23 (a) (1) (A), fall generally into one or the other of three classes.

(1) The purported business, as in the case of the conduct of a country estate or of a farm, was a part of the mode of living of the taxpayer.

(2) The purported business was not such because its real conduct or purpose was not the making of profit, but *primarily* was the self gratification of the owner in some other way than by the acquisition of gain. Such cases are well described as hobby cases.

(3) That the real purpose of the purported business was the evasion of taxes.

We believe that no case will be found, other than the present case, in which a business having all of the indicia which, in common acceptation, would place it within the classification of a business, has been held not to be such within the intent of Section 23 of the Internal Revenue Code, upon evidence only:

(a) That the owner was a wealthy man.

(b) And that the business had never made money.

The Authorities Cited in the Tax Court's Opinion.

The Tax Court in its opinion had cited five cases, no one of which appears to support either the conclusions which the Court reached in the present case or its decision.

The first of these is:

Deering vs. Blair, Commissioner, 23 F. 2nd. 975-976, C. C. A. D. C.

The facts show that Reginald C. Vanderbilt had owned a very extensive country place, which was also operated as a stock farm; that he had little or nothing to do with the actual conduct of the business affairs of the property, and that the losses were continuous and heavy.

The Tax Court in its opinion said, page 976:

"In view of this apparently unbroken record extending from the beginning to the close of Mr. Vanderbilt's operation of the farm, we think that the Board was justified in the conclusion *that the farm was operated as a place of pleasure, exhibition, and social diversion.*"

But the Court in its opinion also stated, page 976:

"An occupation or employment will not be excluded from the *classification of business merely because it actually results in loss instead of profit.*"

All emphasis in quotations from authorities in this brief is added unless otherwise noted.

Comment: It will be noted that the "character" of the operation supported by the fact that it entailed losses, influenced the decision that the losses were not deductible.

That the conduct of the White Laboratory from its inception was and is a business in any ordinary acceptance of the word, can hardly be questioned.

And certainly the modest way in which Mr. White's business was begun and carried on from 1936 to 1952, when he removed to Bel Air, would not indicate any possible purpose to relate it to "exhibition and social diversion." (45a-46a.)

The second case cited in the Tax Court's opinion is:

Chaloner vs. Helvering, Commissioner, 69 F. 2d, 571, C. C. A. Dist. Col. (1934).

In a per curiam it is said, page 572:

> "* * * The record discloses that petitioner is an independently wealthy man, who for twenty years has indulged *his hobby for writing books without realizing any income therefrom.* The only thing he has to show for his work is a warehouse full of books. * * *"

Comment: The facts of the *Chaloner* case certainly disclose no parallel with those of the present case.

The *Chaloner* case definitely is a "hobby" case with no complications.

The activities of the taxpayer there had none of the indicia, and nothing of the character of a business.

The third case cited by the Court is:

Thacher v. Lowe, 288 Fed. 994, Dist. Court S. D. N. Y. (1922.)

This again was a case involving the operation of a farm, in this instance by a lawyer at his place of residence. The Court said, page 994:

> "I have no doubt that a lawyer may operate a farm for profit. However unlikely it may be that he will succeed in the business, the enterprise *may in fact be intended as a business.*
>
> But it is equally clear that a lawyer may run his farm merely as an adjunct to his country place *and between the two the test appears to me to be only of his actual intention.* Moreover, in ascertaining that intention, I can see no escape from making the crux of the determination his receipts and expenditures."

Comment: It is plain that the latter statement is not one of a principle or rule of law, but plainly one apt and intended to be applicable to the particular facts of the case there under consideration, which, equally plainly, it was.

In the present case the evidence *does not* present a question whether the enterprise was *intended* to be a business. Mr. White has testified to his purpose and intention. (40a.)

Every fact in evidence supports his testimony unless it can be said that his business was not a business because it did not make money.

The fourth case cited in the Tax Court's opinion is:

Louise Cheney, 22 B. T. A. 672-674.

This case involved operation of a farm by the taxpayers primarily with purpose to supply themselves with milk and other produce, the incidental surplus being offered first to farm employees, upon all of which a bookkeeping charge was made, and the remainder sold to others.

It was held "upon all of the evidence not to be operated as a business, and losses sustained not deductible." Opinion, page 674:

> "The primary intention was not to run a business or to make a profit, but to produce good food for home consumption * * * It would be specious to say that a vain hope that on some remote day a profit *may result is enough to give the operation of the farm the character of a trade or business.* It is far different from saying, as the Board and Courts have in other cases, *that the fact of a loss does not deprive a business enterprise of its character as a business.*"

Comment: Like the *Deering* case, this case is within the first classification above mentioned. The farm was conducted, not primarily as a business, but as an adjunct to the mode of living of the taxpayers.

(There was a dissent in the *Cheney* case).

The Tax Court's opinion next quotes from:

Cecil v. Commissioner, 100 F. 2d., 896, 899, C. C. A. 4th (1939.)

This case involved conduct of Biltmore House and gardens as open to the public for an admission charge. The case is very carefully considered and we beg leave to quote from it at some length. The Board had held that the expenses of the operation were not deductible.

Headnotes 4, 5 and 8 read:

> "(4) That substantial losses rather than some net profit have resulted does not prevent enterprise carried on by taxpayer from being a 'business' within the meaning of statute permitting deduction of necessary expenses paid or incurred in carrying on a business.
>
> Revenue Act 1928, Section 23 (a) 26 U. S. C. A. Section 23 (a)."

"(5) If gross receipts from any enterprise are practically negligible, in comparison with expenditures, inference may be compelled *that taxpayers' real motives were personal pleasure* and prevent deduction of expenses incurred in carrying on the enterprise.

Revenue Act of 1928, Sec. 23 (a) 26 U. S. C. A. Sec. 23 (a)."

Comment: It is submitted that there is no evidence of any kind in the present case upon which to base a conclusion or fair inference that the taxpayer was devoting his time to arduous activity and risking his capital for pleasure or self gratification, unless such inference can be drawn alone from the fact that the taxpayer was wealthy and that his enterprise did not make money.

Headnote—(8) "To constitute a bona fide 'business' so far as to entitle taxpayer to deduct necessary expenses from income, the expenses of operation and the facts as a whole must exclude a finding that the enterprise was only a scheme of tax evasion * * *."

Comment: It is apparent in the present case from the taxpayers' 1948 and 1949 tax returns that losses were greater than the amounts which additionally would have been paid in taxes if there had been no such losses. There was no intimation by the Court or Counsel that there was in this case any purpose to avoid just taxes.

In its opinion page 898, the Court of Appeals said:

"In our opinion the Board acted on a too narrow and restricted interpretation of the statute. The term 'business' as here used was evidently not intended to have a technical meaning, but to be understood in its ordinary acceptation * * *

In United States v. Atlantic Coast Line Co., 4 Cir. 99 F. 2d., 6, 7, this Court in an opinion by Judge Northcott, approved the definition given in Black's

Law Dictionary, that 'business' is a very comprehensive term, and embraces everything about which a person can be employed * * *

In the adjudicated cases which have applied the word as used in section 23 (a) of the Revenue Act of 1928, and in corresponding sections of other income statutes, there is a recurrent expression that the enterprise must have been undertaken for 'gain or profit' and in many of the cases, the test is stated in terms which generally distinguish between 'business and pleasure'."

Comment: In the present case Mr. White's testimony that he intended to sell his services to the public and that he expected to make a profit, surely must be given full credit. (40a.)

In his opening statement counsel for the respondent said: "We do not exactly contend that this man's operations are a hobby, nor that it does not serve a useful purpose." (16a.)

Authorities Other Than Those Cited In the Tax Court's Opinion Upon the First Question Involved.

In

Foran et al., v. Commissioner, 165 F. 2d 705, C. C. A. 5th (January, 1948),

the question was whether the income was capital gain or ordinary income. It was held to be capital gain.

The Court in its opinion said, page 707:

"Also cited is Greene v. Commissioner, 5 Cir. 141 F. 2d 645-646. The distinction between that case and this is found in the majority opinion in these words:

'There was no direct proof of intent or purpose even in the testimony of Mr. Greene the taxpayer, and the Tax Court was required to draw inference

as to this ultimate fact from the circumstantial evidence relevant thereto.'

Here there is direct and positive evidence from the witness who best knows, that this property was for eighteen months being held as an investment and not for sale to customers."

Farish vs. Commissioner of Internal Revenue, 103 F. 2d 63, C. C. A. Fifth Circuit (1939).

From the Court's opinion, page 64:

"So far as the findings of the Board go they are supported by competent evidence but they omit relevant facts shown by the evidence in the record. As to both enterprises the partners testified they expected to make profit, and gave comprehensive reasons for that belief."

Headnote 4:

"The intention of the taxpayer entering partnership formed for breeding polo ponies was dominant factor in determining whether he engaged in venture merely for pleasure or whether he engaged in it for profit, so as to render losses incurred deductible in computing income tax.

Revenue Act 1932, Section 23, 26 U. S. C. A. Section 23."

Comment: In the *Farish* case as in the present case, the testimony as to intention and purpose had been disregarded by the Board.

The Court of Appeals held that the expenses were deductible.

Whitney v. Commissioner Internal Revenue, 73 Fed. 2d 589, C. C. A. 3rd (1934).

The case is concerned with the question of deductibility of expenses of a racing stable. There had been nothing but losses from 1918 when the stable was established, some twelve years. The Court said, page 592:

"There is no substantial evidence to support the conclusion that the pleasure of owning the stable was the primary interest of the petitioner in operating it."

The losses were held to be deductible.

The Court said further that the facts are so similar to those of *Commissioner v. Widener*, 33 Fed. (2d) 833, C. C. A. 3 (cited *post*) that it was controlling.

Comment: There is no evidence of any kind, substantial or other, in the present case, that pleasure in the exacting and arduous work which the conduct of this business demanded, was the primary reason why the business was begun or continued. The evidence is precisely to the contrary.

In

Doggett vs. Commissioner of Internal Revenue, 65 F. 2nd 191, C. C. A. D. C.

the question involved was whether the publication, advertising and sale of books written by an English religious teacher and prophetess for alleged benefit of the American people, and conducted with expectation of profit, was a business, and expenses thereof deductible in computing income tax.

The Court reversed the Commissioner, holding that they were. Headnotes 3 and 4 read:

"3. Proper test of determining whether enterprise constitutes 'business' so as to make expenses thereof deductible from income tax, *is not reasonableness of taxpayers' belief that profit will be realized*, but whether enterprise is entered into and carried on in good faith for purpose of making a profit, *or in belief that profit can be realized thereon, not merely for pleasure, exhibition, or social diversion.*

"4. Test of whether legitimate enterprise constitutes 'business' so as to make expenses thereof deduct-

ible from income tax is whether a person engaged therein shows willingness to invest time and capital on future outcome of enterprise, *whether it be successful or unsuccessful.*

Revenue Act 1926—Section 214(a)(1) 26 U. S. C. A. Section 955(a)(1)."

The Court in its opinion said, page 194:

"It certainly cannot be said that she is conducting this enterprise *either as a hobby or for recreation or pleasure;* and as said in George v. Commissioner, 22 B. T. A. 189; 'The real test is whether the operation was carried on as a business for gain or whether it was carried on for recreation or pleasure.'

And this question is largely a matter of the intent of the petitioner."

Comment: It need hardly be said that these are statements of settled principles of law and are apt to the facts in the case now before this Court.

In

Commissioner of Internal Revenue vs. Widener, 33 Fed. 2d 833, C. C. A. 3d.

the operation of a racing stable was involved. The Board held that the losses were deductible. From the Board's opinion, quoted by the Court, page 833:

"The fact that the petitioners were wealthy enough to afford a hazardous occupation in which they found pleasure despite discouraging losses does not establish the essential nature of the occupation. If they were utterly indifferent to whether there was loss or gain, or if it were shown that the stables were an incident to the social or domestic aspects of their daily lives, the result might be against them, as in Thacker vs. Lowe (D. C.) 288 Fed. 944, 2 A. F. T. R. 1931.

Instead it appears that they devoted themselves seriously and assiduously to the economic promotion of the stables, always in the hope that profit would result."

The Court of Appeals affirmed the determination of the Board.

In

George v. Commissioner, 22 B. T. A. 189, 195,

the Board said in its opinion, page 194:

"The remaining issue is whether or not petitioner operated two orchards as a business.

"*In our opinion the fact that petitioner sustained losses year after year may be of some evidentiary value*, but by itself that fact does not prove that the orchards were not carried on as a business, nor does the fact stressed by the respondent that petitioner had other and larger interests."

"The real test is whether the operation was carried on for recreation or pleasure. *And this question is largely a matter of the intent of the petitioner.*"

In

Edith G. Marx, Petitioner v. Commissioner Internal Revenue, Respondent, 5 T. C. 173,

the question was whether loss resulting from disposition of a yacht of which petitioner had become the owner by testamentary bequest was deductible.

From the opinion of Opper, J., page 174:

"The problem is to ascertain whether the transaction was entered into for profit. *That involves a consideration of the purpose of the principal participant*, although, to be sure, this may be ascertained from conduct as well as words."

The Court further said that:

> "The Petitioner has not used the yacht nor indulged in any conduct inconsistent with a purpose to turn the property to a profit."

The deduction of loss of value was allowed by the decision.

Comment: The Tax Court in the above case apparently gave considerable weight to the evidence as to intention of the taxpayer.

Other cases bearing upon the question of the intention and purpose of the taxpayer as being of controlling importance in considering the question whether he was conducting a business are:

Helvering v. Commissioner of Internal Revenue, 71 F. 2nd 586, C. C. A. 9th;

Margaret A. Amory, 22 B. T. A. 1398;

Lewis v. Commissioner, 34 B. T. A. 996.

The *Amory* case cited involved the conduct of a racing stable.

In its opinion in that case the Board said, page 1399:

> "Petitioner testified categorically that she entered the racing field with an eye to profit, that she would not have done so except she believed it could be profitable. She sought advice on this phase of the matter, and was advised that a racing stable could be operated profitably. * * *
>
> She negatived with vigor any suggestion that the racing stable was a hobby."

Comment: Mr. White testified similarly in the present case. We submit that there is no evidence which raises any question whatsoever of his credibility, and no such question has been raised.

The Tax Court's Inferences and Conclusions Stated Under the Heading "Findings of Fact."

First be it said that there is no dispute about any of the evidential facts in this case. There is no contradiction of any of the testimony of any witness for the taxpayers. No question is raised about the credibility of any of these witnesses. There were no witnesses for the respondent Commissioner.

In such a situation the Courts of Appeals will reach their own conclusions and draw their own inferences from the evidence. *Wright v. Bernet*, 172 F. 2d, 343, C. C. A. 6th; *United States v. United States Gypsum Company*, 333 U. S. 364 (Syl. 7), 68 S. Ct. 525; *Plomb Tool Company v. Sanger*, 193 F. 2d, 260-264, C. C. A. 9th (1952); *Wellington v. Commissioner*, 173 F. 2d, 421, C. C. A. 5th.

In

McGah v. Commissioner, 210 F. 2d, 769, C. C. A. 9th (1954)

Headnote 4 reads:

> "In petition to review decision of the Tax Court, Court of Appeals will give careful attention to the finding of the Tax Court, but will draw its own inferences from undisputed facts."

In considering these inferences and conclusions we ask the Court to bear in mind that they form the sole basis for the Tax Court's ultimate conclusion that the taxpayer was not conducting a "business" in 1948 and 1949, and for the decision that therefore he was not entitled to deduct the ordinary expenses of operating such business in computing his taxable income.

In finding No. 11 the Tax Court said:

> "The ballistics laboratory was of some service and benefit to a limited number of persons and organiza-

tions *but it was not capable of producing income in sufficient amount to off-set the usual expenses.*"

We submit that this was a violent assumption indeed, in view of the fact that here was a well equipped and well conducted establishment, in control of competent men with ample capital available when opportunity might present itself for employment of such capital.

The only evidential basis for such an assumption was that the business had not made money.

It is a matter of too common knowledge to be subject of dispute that in the field of mechanics such temporarily unsuccessful enterprises have gone on to achievement of great financial successes.

The tax returns in evidence show that depreciation was being taken on capital investment of $43,016.74 in 1948 and of $50,156.15 in 1949, which should indicate that the taxpayer had shown considerable confidence that he could make good even if the Court or counsel who suggested this finding did not.

In finding No. 12 the Court says:

"Petitioner had no real expectation of any net income for years subsequent to those in issue."

But even if the state of mind of the taxpayer at the time of the trial in 1953 as to the future prospects of his business was proper to be considered upon the issues before the Tax Court involving returns for 1948 and 1949, the evidence shows:

(a) That he had invested about $300,000.00 in a new plant at Bel Air, Maryland, beginning in 1952;

(b) At the time of the trial he was engaged in performance of an important contract with the U. S. Navy;

(c) He was expecting to have increased business relations with the National Rifle Association which would

be the culmination and fruition of efforts he had been making. (38a-39a.)

(d) He had had conversations, at least, about purchase of his new plant by that organization. (52a.)

The Tax Court considered that Mr. White, in maintaining his opinion as of the time of the trial in 1953, that his enterprise would be profitable, did not take into consideration interest on his new investment. There is no evidence that any interest had been paid, and again it is difficult to see how the issues are affected by the taxpayer's miscalculation as to his future if it was such miscalculation. The Tax Court also thought that it was significant that Mr. White had not charged anything for his services. We think that this is not unusual in connection with a wholly owned business, and certainly the Government could have no complaint because he kept his deductible expenses down.

Finding No. 13:

> "Petitioner did not operate the Ballistics Laboratory as a business or with intent of making a profit during the taxable years 1948 and 1949."

There is not a word or fact directly in evidence to support either of these conclusions. That he did operate it as a business with intention to make a profit, he testified clearly and positively.

If he had any other possible purpose it does not appear in the record of this case. Bearing in mind that Mr. White had embarked upon his venture as a pioneer in a new field; that he was without much experience of any kind in the beginning, and that he had spent four years in the armed forces in the interim, a belief might well have been warranted that in 1948 and 1949 he had made considerable progress, and the very valuable services

which had been rendered to The Van Dorn Company in the early forties would support such a view. (23a-27a.)

Finding No. 14:

"The expenditures claimed were neither ordinary nor necessary expenses of carrying on a trade or business nor losses within the meaning of Section 23 Internal Revenue Code of 1939."

This is the Court's ultimate conclusion and it is, upon the undisputed facts, a conclusion of law.

The statement is made, of course, with reference to White's situation in 1948 and 1949.

We do not definitely know from the findings just what the Court thought Mr. White was doing, if he was not intending to conduct a business in the sense which the word implies.

There is not a word or fact in evidence to indicate that he was devoted to his business as a hobby.

Counsel for the respondent in his opening statement was unwilling to say that it was a hobby. (16a.)

His business had no relation to his mode of living, nor to any aspect of his social life. By no possibility could it be considered to be conducted as a sporting venture of any kind.

Without the slightest question he never could have had any idea that he would be advantaged financially by incurring business expenses in excess of the amount of the tax deduction which resulted from deduction of his business expense.

In Conclusion on the First Question Involved.

We submit most earnestly that neither the evidence nor the law justify the Court's conclusions that the taxpayer in 1948 and 1949 was not conducting a business

within the intent and purpose of Section 23 of the Internal Revenue Code of 1939.

THE SECOND QUESTION INVOLVED.

2. Two issues presented by the pleadings were determined by the Tax Court.

One involved the question whether there were deficiencies of the joint income tax liability of the taxpayers, who were husband and wife, for the calendar year of 1948 of $1,088.51 and for the year 1949 of $10,014.28, or in the total amount of $11,102.79.

The Tax Court answered this question "Yes."

The taxpayers contend that the answer should be "No."

Little additional discussion of this question is necessary. If Mr. White was merely indulging a hobby in 1948 and 1949, then it would be admitted that his expenses would not be allowable as deductions.

The Tax Court's decision would seem to have been reached upon the theory that he was, but almost complete disregard of the convincing evidence to the contrary, as it is disregarded in the statements of the findings and opinion of the Court, is difficult to understand.

We can only repeat that the decision is not only not supported by any substantial evidence which can be controlling but that the authorities relied upon by the Tax Court and other authorities cited in this brief convincingly show that the decision is contrary to the intent and purpose of the law.

THE THIRD QUESTION INVOLVED.

3. The other issue involved the question of the taxpayers' right to refund of $7,671.75 which had been duly claimed by them as overpayment of income tax for the year 1948.

This claimed overpayment was the sum of two items: One was the consequence of an arithmetical error to the disadvantage of the taxpayers upon the face of the taxpayers' return for that year, and the other the amount of understatement of the estimated tax paid.

That there were such errors was conceded by the Commissioner, and by counsel for the respondent upon the trial.

By its decision that there was a deficiency for the year 1948, the Tax Court answered this question of the right to refund "No."

The taxpayers contend that the answer should be "Yes."

The Court did not enter particular decision upon the question of right to this refund.

This question, as it was presented by the pleadings, also was determined by the conclusion reached by the Court upon the First Question Involved.

The Commissioner had disallowed all of the business expenses, and the Court, in deciding that none of them was deductible under Section 23 of the Internal Revenue Code of 1939, because the taxpayer, in 1948 and 1949, was not conducting a business within the intent of that section, sustained the Commissioner in this action.

It necessarily followed that if there was a deficiency in 1948, there could be no refund.

SUMMARY.

What the decision of the Tax Court in this case means is that the Commissioner may undertake to impose a penalty upon the taxpayer's continued operation of his business by action which would deprive him of the statutory right to deduct his expenses in computing his taxable income, for no other reasons than that the business has not made money and that the taxpayer is wealthy.

How disastrous such a ruling, if sustained, might be is well exemplified in the present situation of this taxpayer.

We can only assert without fear of contradiction, that there is no statute which grants any such authority to the Commissioner of Internal Revenue, and no support in decision by the Courts for any such action by him.

RELIEF.

The decision of the Tax Court that there were deficiencies of income tax upon the returns of the taxpayers for the years 1948 and 1949 is erroneous and should be reversed.

An order should be made that the taxpayers are entitled to a refund of $7,671.75 as overpayment of income tax for the year 1948.

Respectfully submitted,

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